



FOR PUBLICATION

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A handwritten signature in black ink, appearing to read "Hannah L. Blumenstiel", is written over a horizontal line.

HANNAH L. BLUMENSTIEL
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re:) Case No. 13-30827 HLB
)
DAVID WILLIAM BARTENWERFER and) Chapter 7
KATE MARIE BARTENWERFER,)
)
Debtors.)
) Adv. Proc. No. 13-03185 HLB
KIERAN BUCKLEY,)
)
Plaintiff,)
)
v.)
)
DAVID WILLIAM BARTENWERFER and)
KATE MARIE BARTENWERFER,)
)
Defendants.)

MEMORANDUM DECISION FOLLOWING REMAND

On December 22, 2017, the Bankruptcy Appellate Panel of the Ninth Circuit (the "BAP") issued a decision (Dkt. 179; the "BAP Decision") that, among other things, vacated and remanded in part this court's judgment of April 19, 2016 (Dkt. 70, as amended by Dkt. 125 and Dkt. 143; the "Judgment"). The Judgment declared a debt owed to Mr. Kieran Buckley by Chapter 7 Debtors David and Kate Bartenwerfer nondischargeable under section 523(a)(2)(A)¹. The BAP Decision affirmed the Judgment

¹ Unless otherwise indicated, all statutory citations shall refer to Title 11 of the United States Code, aka the "Bankruptcy Code."

1 as to Mr. Bartenwerfer but vacated and remanded the Judgment as
2 to Mrs. Bartenwerfer so that the court could determine whether
3 Mrs. Bartenwerfer "knew or had reason to know of Mr.
4 Bartenwerfer's fraudulent omissions" in connection with the
5 sale of a house to Mr. Buckley (the "Remanded Issue"). [BAP
6 Decision, 22:23-25.]

7 After a delay caused by the parties' respective appeals
8 from the BAP Decision and this court's need for additional
9 briefing, the court reopened the evidentiary record to accept
10 additional testimony on the Remanded Issue, which the parties
11 elicited at a trial conducted on December 12, 2018.

12 **A. Background**

13 For the sake of brevity, the court will not repeat but
14 incorporates by reference the relevant facts set forth in its
15 Memorandum Decision of April 1, 2016 (Dkt. 69), which explain
16 the origins and nature of the parties' dispute. The court also
17 incorporates by reference (to the extent relevant) the BAP
18 Decision's recitation of the procedural posture of this action.

19 **B. Jurisdiction**

20 This proceeding requests a determination of the
21 dischargeability of a debt under section 523(a)(2)(A) and
22 constitutes a core proceeding in which this court may enter a
23 final judgment. 28 U.S.C. § 1334(b); 28 U.S.C. § 157(a); 28
24 U.S.C. § 157(b)(2)(I); General Order No. 24 of the United
25 States District Court for the Northern District of California.

26 **C. Findings of Fact as to Remanded Issue**

27 When Mr. and Mrs. Bartenwerfer acquired the home located
28 at 549 28th Street, San Francisco, California (the "Property"),

1 they intended to remodel it. At first, their plans were
2 relatively modest. Later, however, after Mr. Bartenwerfer
3 became (according to Mrs. Bartenwerfer) "inspired," those plans
4 morphed into a gargantuan project that involved tearing off the
5 back wall of the Property and increasing its square footage by
6 approximately one third. Mr. Bartenwerfer assumed full-time
7 responsibility for managing these extensive renovations, even
8 though he had no training or education in construction and did
9 not possess a contractor's license.

10 At all times relevant to this action, Mrs. Bartenwerfer
11 worked elsewhere. She currently works at Genentech. At the
12 time of the original trial of this action, she had worked at
13 McKesson for approximately ten years. Her work at both places
14 was and remains largely the same. She works in Genentech's Law
15 Department, assisting with licensing and regulatory issues.
16 She has no specialized legal training, other than that which
17 she might have obtained through her on-the-job experience.

18 In 2008, Mrs. Bartenwerfer obtained a California real
19 estate broker's license. She obtained this license after
20 studying books and other materials she obtained from some
21 unspecified source; she attended no classes. After completing
22 the required coursework, she took an exam. Although she failed
23 this exam the first time she took it, she ultimately passed and
24 received her license.

25 Mrs. Bartenwerfer never "used" her broker's license,
26 explaining that she never associated her license with a real
27 estate agency and never once acted as a broker for any buyer or
28 seller of real property. She viewed the real estate business

1 as too unstable and too risky to pursue as a profession. And
2 although she originally wanted to obtain this license so that
3 she could earn a commission on the sale of the Property, she
4 came to view herself as too inexperienced to take part in what
5 she believed to be a "complicated" real estate transaction.
6 When she and Mr. Bartenwerfer sold the Property to Mr. Buckley,
7 they engaged Mr. Peter Monti as their agent. Mrs. Bartenwerfer
8 no longer holds an active broker's license.

9 Mr. and Mrs. Bartenwerfer lived in the Property until
10 approximately April 2007, when the renovations made continued
11 use of the Property as a residence impossible. Mrs.
12 Bartenwerfer could not recall setting foot on the Property
13 between April 2007 and approximately November 2007, when they
14 put the Property on the market. This means that she never used
15 the renovated Property as her residence. She never kept
16 clothes in the new master closet, never slept in the new master
17 bedroom, etc.

18 Managing the renovation of the Property was Mr.
19 Bartenwerfer's full-time job. Mrs. Bartenwerfer never
20 interacted with or gave instructions to laborers or
21 contractors; never met with or gave instructions to architects;
22 never wrote checks to contractors; etc. Mr. Henry Karnilowicz,
23 a consultant employed to assist Mr. Bartenwerfer with obtaining
24 necessary construction permits, abating violations, and
25 obtaining approval of the construction at the Property,
26 corroborated this aspect of Mrs. Bartenwerfer's testimony. Mr.
27 Karnilowicz only ever dealt with Mr. Bartenwerfer - never with
28

1 Mrs. Bartenwerfer - regarding the many outstanding permits and
2 notices of violations pertaining to the Property.

3 In November 2007, as they prepared to market the Property
4 for sale, Mr. and Mrs. Bartenwerfer executed a Real Estate
5 Transfer Disclosure Statement, as well as a supplement thereto
6 (Plaintiff's Ex. 2; the "TDS")². Mrs. Bartenwerfer admitted
7 that she understood that the purpose of the TDS was to disclose
8 any defects or problems associated with the Property of which a
9 potential purchaser might want to be aware. She also
10 understood that her signature on the document constituted her
11 representation that the information disclosed in the TDS was
12 true and correct. And she understood that she had a duty to
13 update the TDS if any new material information came to light.

14 Even though Mr. and Mrs. Bartenwerfer attested in the TDS
15 that they answered the questions therein in "an effort to fully
16 disclose all material facts relating to the Property" and
17 certified that "the information provided [was] true and
18 correct," the TDS failed to disclose numerous significant
19 problems. As detailed in the court's April 1, 2016 Memorandum
20 Decision, the TDS failed to disclose several leaks, quite a few
21 open permits, at least one notice of violation, several
22 malfunctioning windows, and a missing fire escape. [Dkt. 69;
23 pp. 11-19.]

24 The TDS is a "check-the-box" form, with only a very few
25 places in which narrative information can be added. For
26 example, item A requires the seller to disclose whether the

27
28 ² When Mr. and Mrs. Bartenwerfer executed the TDS, they had not yet married,
so Mrs. Bartenwerfer is identified in and executed the TDS as Kate Pfenninger.

1 given property has certain fixtures, systems, or features. The
2 seller accomplishes this by checking a box next to each
3 specified feature or fixture that exists in the property to be
4 sold. For example, if the property has "Washer/Dryer Hookups,"
5 the seller will check the box next to that feature. He or she
6 will do the same for other features or systems, such as smoke
7 detectors, garbage disposal, dishwasher, fireplace(s), sump
8 pump, central heating, etc.

9 The TDS also requires the seller to disclose whether he or
10 she is aware of certain defects or problems by checking either
11 a box marked "yes" or a box marked "no." If the seller checks
12 the "yes" box - thereby confirming the existence of a
13 particular defect or problem - he or she then must check other
14 boxes that indicate the area where the problem exists, such as
15 "roof(s)" or "windows" and then describe the problem in a short
16 section that allows for a narrative answer.

17 In response to all questions relevant to this dispute,
18 i.e., all questions that afforded Mr. and Mrs. Bartenwerfer an
19 opportunity to disclose the numerous defects from which the
20 Property suffered, they answered "no." Their omission from the
21 TDS of these significant issues gave rise to a decade of
22 litigation.

23 During the December 12 trial, Mrs. Bartenwerfer's
24 testimony revealed that she did not remember much about when
25 and how the TDS was prepared, other than that she did not play
26 any significant role in doing so. She did not, for example,
27 remember signing the TDS, authorizing Mr. Bartenwerfer to
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1 prepare the TDS, or even whether it was Mr. Bartenwerfer who
2 did so.

3 During the court's original trial, which took place on
4 January 19 and 22, 2016, Mr. Bartenwerfer denied having
5 completed the TDS on his wife's behalf. This directly
6 contradicted the testimony he gave during the 19-day state
7 court trial that preceded the bankruptcy litigation, in which
8 he admitted that he prepared the TDS on behalf of himself and
9 Mrs. Bartenwerfer. The court sees no need to revisit its prior
10 finding that Mr. Bartenwerfer completed the TDS. The question,
11 however, is what did Mrs. Bartenwerfer do, if anything, to
12 verify the information disclosed in the TDS and then, assuming
13 she tried to verify those disclosures, whether that effort was
14 sufficient to insulate her from a finding of
15 nondischargeability due to Mr. Bartenwerfer's fraudulent
16 omission of material information.

17 During the December 12 trial, Mrs. Bartenwerfer testified
18 that, to the best of her recollection, the TDS was prepared
19 during a visit to the Property in November 2007, at which she,
20 Mr. Bartenwerfer, and their agent, Mr. Monti, were present.
21 She consistently and credibly testified that she verified
22 whatever information she could by visually inspecting the
23 Property during that visit, such as, for example, confirming
24 visually that the Property had a dishwasher and a range. For
25 everything else, she relied on Mr. Bartenwerfer to confirm
26 orally the accuracy of the information disclosed in the TDS.

27 Mr. and Mrs. Bartenwerfer also signed a sales contract, in
28 which they represented that they had "no knowledge or notice

1 that the Property has any material defects other than as
2 disclosed . . . in the [TDS] or other writing before Acceptance
3 or as soon thereafter as practicable." [Plaintiff's Ex. 1,
4 ¶ 19.] Mrs. Bartenwerfer admitted that she understood
5 paragraph 19 of the sales contract when she signed it.

6 Mrs. Bartenwerfer did not take any steps to confirm what
7 Mr. Bartenwerfer told her. She did not, for example, ask to
8 see any construction plans or drawings pertaining to the
9 renovation of the Property, which might have revealed the
10 missing fire escape. She did not ask to review any of the
11 permits pertaining to the construction work done on the
12 Property nor did she speak to Mr. Karnilowicz (the permit
13 consultant), which might have revealed the falsity of the
14 affirmative representations in the TDS that there were no open
15 permits pertaining to the renovation. She did not review
16 quotes or invoices from contractors working on the Property,
17 which might have revealed that, just a month prior to their
18 execution of the TDS, Mr. Bartenwerfer had received a quote for
19 work to repair existing leaks and to prevent their recurrence.

20 When asked whether she saw any problems with the
21 Property's windows, Mrs. Bartenwerfer simply said she "was not
22 aware of any problems." The court infers from this testimony
23 that Mrs. Bartenwerfer might have asked Mr. Bartenwerfer
24 whether there were any problems with the windows, but that she
25 did not attempt to open or shut the windows herself, which
26 might have revealed that they did not operate properly.

27 Other than the information she confirmed with a visual
28 inspection, Mrs. Bartenwerfer based her attestations in the TDS

1 on what Mr. Bartenwerfer told her. Unfortunately, much of what
2 Mr. Bartenwerfer told her - and much of the information
3 disclosed in the TDS - was false, and Mr. Bartenwerfer knew it
4 was false when he prepared the TDS. He also did nothing to
5 correct the TDS over the ensuing months, as they marketed the
6 Property, or when Mr. Buckley made an offer to and ultimately
7 did purchase the Property, or after that transaction closed.

8 Mrs. Bartenwerfer's reliance on Mr. Bartenwerfer continued
9 through discovery in this proceeding. For example, Mr. Buckley
10 served Mrs. Bartenwerfer with interrogatories, one of which
11 asked her to "[p]lease explain in detail why [she] did not
12 believe [her] representations regarding water leaks at the
13 Property were false when the representations were made."

14 [Plaintiff's Ex. 37, pp. 13-14 (Interrogatory No. 1 and
15 Response).] In response, Mrs. Bartenwerfer stated: "During
16 construction, a problem was discovered with the roofing
17 material above the master bedroom closet. That problem was
18 resolved during the construction process and the responding
19 party did not consider the problem to be a 'leak' of the sort
20 for which disclosure was required since it occurred during the
21 construction of the Property and was resolved during the
22 construction of the Property. Responding party was not aware
23 of any other problem [sic] related to water intrusion or
24 leaks." [Id.]

25 Similarly, Interrogatory No. 11 asked Mrs. Bartenwerfer to
26 "[p]lease explain in detail why [she] did not believe that
27 [she] failed to disclose the true status of permits at the
28 Property with the intention and purpose of deceiving [Mr.

1 Buckley]." [Plaintiff's Ex. 37, p. 16.] Mrs. Bartenwerfer
2 responded: "Responding party believes the true status of the
3 permits at the Property was disclosed to [Mr. Buckley].
4 Responding party was not obligated to provide copies of the
5 final permits and, in any event, unable to provide copies of
6 the permits to [Mr. Buckley] because responding party need
7 [sic] to maintain control of the same were for [sic] the City
8 and County of San Francisco to provide final approval of the
9 permits." [Id.]

10 Mrs. Bartenwerfer verified under penalty of perjury that
11 her responses to Mr. Buckley's interrogatories were "true of my
12 own knowledge, except as to matters which are therein stated
13 upon my information and belief, and as to those matters, I
14 believe them to be true." [Plaintiff's Ex. 37, p. 22.] Mrs.
15 Bartenwerfer did not qualify her responses to Interrogatory
16 Nos. 1 and 11 as based on information and belief; thus, one
17 should be able to accept her responses as based on her own
18 personal knowledge. Except that - assuming one believes her
19 testimony - they were not.

20 If one accepts Mrs. Bartenwerfer's testimony as truthful,
21 these responses could not have been based on her personal
22 knowledge. She never lived in the renovated Property; she
23 never saw and did not possess or maintain the construction
24 permits; she never interacted with contractors, laborers,
25 architects, or consultants; she never asked for or reviewed
26 construction plans or drawings; and she never asked for or
27 reviewed invoices or estimates for construction work.

28 According to Mrs. Bartenwerfer's testimony, Mr. Bartenwerfer

1 served as her sole source for information concerning the
2 Property, other than what she could verify visually.

3 When confronted with her responses to the foregoing
4 written discovery during the December 12 trial, Mrs.
5 Bartenwerfer waffled. She claimed that she intended her
6 responses - which were clearly drafted as hers and hers alone -
7 to be interpreted as both hers and Mr. Bartenwerfer's. This
8 feeble explanation does nothing for her credibility.

9 All of that said, the court believes that Mrs.
10 Bartenwerfer told the truth on the stand. She answered
11 questions earnestly, taking care to ask for clarification when
12 needed. And she consistently, clearly, and credibly maintained
13 - perhaps to her detriment - that, when confronted with a
14 question concerning the Property about which she had no
15 personal knowledge and as to which she could not determine an
16 answer based on her visual inspection, she asked Mr.
17 Bartenwerfer and relied unflinchingly on whatever he told her.

18 **D. Conclusions of Law as to Remanded Issue.**

19 Mr. Buckley's complaint contained a single cause of
20 action, based on section 523(a)(2)(A). Section 523(a)(2)(A)
21 excepts from discharge any debt obtained by "false pretenses, a
22 false representation, or actual fraud." To obtain a finding of
23 nondischargeability under section 523(a)(2)(A), a creditor must
24 prove by a preponderance of the evidence that: (1) the debtor
25 made a fraudulent misrepresentation or omission, or engaged in
26 deceptive conduct; (2) the debtor knew of the falsity or
27 deceptiveness of his or her statements or conduct; (3) the
28 debtor made the representation with the intention and purpose

1 of deceiving the creditor; (4) the creditor justifiably relied
2 on the representation; and (5) the creditor suffered damage as
3 a proximate result of the debtor's fraudulent statements or
4 conduct. In re Slyman, 234 F.3d 1081, 1085 (9th Cir. 2000).

5 The BAP affirmed this court's conclusion that Mr. Buckley
6 succeeded in proving all of the foregoing elements as to Mr.
7 Bartenwerfer. [BAP Decision, 23:16-19.] As relevant to this
8 decision, the BAP vacated this court's Judgment as to the
9 Remanded Issue.

10 In their supplemental briefing on the Remanded Issue, it
11 became clear that the parties no longer seriously dispute that
12 Mrs. Bartenwerfer had no actual knowledge of Mr. Bartenwerfer's
13 fraud. They remain in dispute as to whether she "should have
14 known" of his fraud. And they both offered argument that
15 strayed from the Remanded Issue.

16 Mr. Buckley characterizes Mrs. Bartenwerfer's attitude
17 toward the truth about the Property's condition as
18 "indifferent". He points out (correctly) that the court
19 received no evidence that Mrs. Bartenwerfer could not have
20 reviewed the permits, construction drawings, invoices, or other
21 relevant documents; or that she could not have spoken to
22 contractors or to others, such as Mr. Karnilowicz, concerning
23 the Property. According to Mr. Buckley, had Mrs. Bartenwerfer
24 paid "minimal attention" to the facts to which she attested,
25 she would have become aware of their falsity.

26 Mr. Buckley also contends that Mrs. Bartenwerfer can be
27 held directly liable for the misrepresentations made to Mr.
28 Buckley because she: (a) signed the TDS without doing the

1 proper due diligence; and (b) failed to disclose that many of
2 the representations she made in the TDS were not based on
3 personal knowledge. [Plaintiff's Scienter Brief re Kate
4 Bartenwerfer, Dkt. 187, pp. 19-24.] According to Mr. Buckley,
5 this "grossly reckless" behavior satisfies section
6 523(a)(2)(A)'s scienter requirement and affords a basis upon
7 which to render the debt nondischargeable that does not require
8 imputation of Mr. Bartenwerfer's fraud to Mrs. Bartenwerfer.
9 The court respectfully declines to address arguments beyond the
10 Remanded Issue. The BAP did not invite the parties to offer or
11 this court to consider new theories relating to Mrs.
12 Bartenwerfer's knowledge or intent.

13 Mrs. Bartenwerfer characterizes herself as an "honest but
14 unfortunate" debtor. She believes she acted reasonably by
15 asking Mr. Bartenwerfer to confirm the representations he made
16 (and that she adopted as her own) and argues that this
17 constituted the "minimal attention" required of her under
18 relevant caselaw. She maintains that she would not have known,
19 for example, how to read construction drawings or permits even
20 if she had asked for them, so doing so would not have enabled
21 her discovery of the falsity of Mr. Bartenwerfer's
22 representations as to the Property's condition.

23 Mrs. Bartenwerfer also continues to argue that she and Mr.
24 Bartenwerfer were not partners. [Defendants' Brief re
25 Knowledge and Intent of Kate Bartenwerfer, Dkt. 189, pp. 9-12.]
26 This, too, strays from the Remanded Issue and ignores the BAP's
27 express affirmance of this court's finding that Mr. and Mrs.
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1 Bartenwerfer were partners with respect to the Property. [BAP
2 Decision, 22:9-20.]³

3 The Remanded Issue is limited to whether Mrs. Bartenwerfer
4 knew or should have known of her husband's fraud, such that it
5 can be imputed to her for purposes of section 523(a)(2)(A).
6 The seminal case in the Ninth Circuit on the issue of
7 imputation of fraud is In re Huh, 506 B.R. 257 (B.A.P. 9th Cir.
8 2014) (*en banc*). Huh involved an action under section
9 523(a)(2)(A) that arose from the sale of a retail market. The
10 debtor, Mr. Huh, was a licensed real estate broker and operated
11 a real estate and business brokerage. Mr. Kim worked as a
12 part-time sales agent associated with Mr. Huh's brokerage. Mr.
13 Kim served as the seller's agent in the transaction involving
14 the market.

15 During the negotiations leading up to the sale, Mr. Kim
16 made numerous misrepresentations to the buyer as to the
17 profitability of the market and the extent of its inventory.
18 He also failed to disclose that local authorities had cited the
19 market for several fire and health code violations and that,
20 unless the buyer took immediate and expensive corrective
21 measures, he would be unable to obtain a license to operate the
22 business.

23 _____
24 ³ "We agree with the bankruptcy court's agency finding. Mrs. Bartenwerfer's
25 partnership/agency relationship with Mr. Bartenwerfer was established by not
26 only her co-ownership of the Property, which is a factor tending to establish
27 partnership, but also because she signed the TDS and sales contract and she
28 stood to benefit from the successful completion of the project and sale of the
Property. That she participated little in the project and delegated authority
to Mr. Bartenwerfer to manage it does not defeat the forming of a partnership.
A partnership can exist as long as the parties have the right to manage the
business, even though in practice one partner relinquishes the day-to-day
management to the other partner." (citations omitted)

1 After the worst-case scenario played itself out and the
2 buyer was forced to sell the market at a substantial loss, he
3 sued Mr. Kim in state court and won. During post-trial
4 litigation, the buyer succeeded in adding Mr. Huh as a
5 defendant and in obtaining a judgment against him in an amount
6 that exceeded \$900,000. Mr. Huh then filed a petition for
7 relief under Chapter 7.

8 The buyer/judgment-creditor commenced an adversary
9 proceeding in which he asked the bankruptcy court to except his
10 judgment from Mr. Huh's discharge. After trial, the bankruptcy
11 court concluded that Mr. Kim was Mr. Huh's agent but declined
12 to impute Mr. Kim's fraud to Mr. Huh. In support of its
13 conclusion, the bankruptcy court noted, among other things,
14 that Mr. Huh had never communicated directly with the buyer;
15 had never made any affirmative misrepresentations to the buyer
16 or instructed Mr. Kim to make any misrepresentations on his
17 behalf; that Mr. Huh knew nothing about the market; and that
18 Mr. Huh had not even been aware of the market or its purchase
19 until after that transaction closed. The bankruptcy court
20 entered judgment in favor of Mr. Huh.

21 The BAP affirmed. 506 B.R. at 259. The BAP held that
22 imputation of an agent's fraud to the agent's principal
23 requires proof of the principal's culpability, i.e., that the
24 principal knew or should have known of the agent's fraud. Id.
25 at 271-272. Considering the factual findings made by the
26 bankruptcy court as to Mr. Huh's lack of knowledge of the
27 transaction and of Mr. Kim's fraud, the BAP concluded that the
28 bankruptcy court had correctly decided that the buyer's state

1 court judgment should not be excepted from discharge. Id. at
2 272.

3 Huh does not explicitly obligate a debtor to pay "minimal
4 attention" to his or agent's representations or conduct to
5 avoid imputation of the agent's fraud. In fact, Huh does not
6 discuss what efforts, if any, a debtor must make to avoid a
7 finding that he or she *should have known* of the agent's fraud
8 and does not describe what Mr. Huh did or did not do to
9 supervise Mr. Kim's conduct. The caselaw followed by Huh,
10 however, provides some meaningful guidance.

11 Huh adopted the rule announced by the Eighth Circuit Court
12 of Appeals in Matter of Walker, 726 F.2d 452 (8th Cir. 1984).
13 Walker involved an action under section 523(a)(2)(A) against a
14 debtor whose wife made fraudulent misrepresentations to a bank
15 for the purpose of inducing the bank to loan more money than it
16 otherwise would have to the debtor's business. The parties did
17 not dispute that the debtor's wife served as his agent.

18 The bankruptcy court held that this agency relationship,
19 as well as the fact that both husband and wife enjoyed the
20 benefit of the fraudulently obtained funds, justified
21 imputation of the wife's fraud to her debtor/husband. The
22 district court disagreed, reasoning that, in order hold a
23 debtor liable for his agent's fraud, the party seeking a
24 declaration of nondischargeability must prove that the debtor
25 knew or should have known of the fraud. The Eighth Circuit
26 agreed with the district court's "knew or should have known"
27 standard but reversed and remanded because it found the factual
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1 record developed in the bankruptcy court inconclusive as to
2 that issue. 726 F.2d at 454.

3 In discussing the "should have known" component of the
4 standard to which it adhered, the Eighth Circuit briefly
5 examined cases in which courts had imputed an agent's fraud to
6 a debtor. It found that in each such case, the debtors were
7 found to be "recklessly indifferent" and possessed "no reason,
8 good or bad, for their lack of knowledge." Id. (citations
9 omitted). The Eighth Circuit held that "[t]he debtor who
10 abstains from all responsibility for his affairs cannot be held
11 innocent for the fraud of his agent if, had he paid minimal
12 attention, he would have been alerted to the fraud." Id. Huh
13 quotes this language and adopts wholesale Walker's "knew or
14 should have known" standard,⁴ so it is fair to say that the BAP
15 also approves of the guidance offered by Walker as to whether a
16 debtor "should have known" of his or her agent's fraud.

17 The court could find no caselaw from within the Ninth
18 Circuit that discusses the "should have known" prong of the
19 Walker rule. Decisions from courts in other jurisdictions that
20 follow Walker and/or its "knew or should have known" standard,
21 however, prove helpful.

22 Helena Chem. Co. v. Richmond (In re Richmond), 429 B.R.
23 263 (Bankr. E.D. Ark. 2010) involved a creditor's demand for
24 (among other things) a declaration of nondischargeability under
25 section 523(a)(2)(A). The creditor had loaned money to one or
26 more of the debtor's businesses, which the debtor's son

27
28 ⁴ Huh, 506 B.R. at 266.

1 managed. The Debtor orally relinquished managerial
2 responsibility to his son, rather than documenting that
3 delegation in accordance with the applicable corporate
4 governance documents. The debtor did this because he knew of
5 his son's serious financial problems and wished to conceal
6 those problems from creditors.

7 Unfortunately, the debtor's son persisted in his financial
8 misconduct while running his father's businesses. He made
9 material misrepresentations to the plaintiff/creditor
10 concerning the existence and ownership of certain equipment
11 that was to serve as the creditor's collateral; fraudulently
12 inflated cash, inventory, and receivables; and willfully failed
13 to disclose intercompany debt. He also concealed the
14 businesses' insolvency through an elaborate check-kiting
15 scheme.

16 While the bankruptcy court received some evidence that
17 proved the father's direct involvement in a small portion of
18 his son's fraudulent activities, for the most part the debtor
19 did little to supervise his son. He signed whatever checks and
20 other documents his son placed before him; failed to monitor
21 bank accounts; and never attempted to verify the accuracy of
22 tax returns, financial statements, loan applications, and other
23 documents his son prepared on his behalf.

24 The creditor argued that the bankruptcy court should
25 impute the son's fraud to his father/debtor. The debtor
26 attempted to distance himself from his son's misconduct,
27 pleading ignorance to most of it. The bankruptcy court agreed
28 with the creditor, emphasizing that the debtor knew of his

1 son's insolvency, tax problems, and pattern of financial
2 mismanagement but nevertheless gave him carte blanche.
3 Richmond, 429 B.R. 290-291. According to the bankruptcy court,
4 this justified a judgment in favor of the creditor under
5 section 523(a)(2)(A). Id. at 295.

6 In Warthog, Inc. v. Zaffron (In re Zaffron), 303 B.R. 563
7 (Bankr. E.D.N.Y. 2004), a creditor that had leased a large
8 conference center to an entity through which the debtor and his
9 partner conducted business demanded a judgment of
10 nondischargeability under section 523(a)(2)(A) as to the debt
11 arising from the lease. Prior to execution of the lease, the
12 debtor's partner made numerous misrepresentations concerning
13 financing commitments he and the debtor had received from banks
14 and other investors; commitments from alleged clients as to use
15 of the conference center; and as to the debtor's experience as
16 an investment banker. The partner made some of these
17 misrepresentations in the debtor's presence, but the debtor made
18 no effort to correct them. As to the partner's other false
19 statements, the debtor claimed ignorance.

20 The bankruptcy court declared the debt nondischargeable.
21 The court found it "difficult to believe that based on the
22 actual facts as the Debtor knew them to be" the creditor would
23 have leased such large premises to the debtor and his partner
24 without representations as to financing. It also noted the
25 debtor's failure to correct the false representations made in
26 his presence. This "reckless indifference" to the truth
27 justified a judgment in favor of the creditor under section
28 523(a)(2)(A). Id. at 572-573.

1 In Am. Inv. Bank, N.A. v. Hosking (In re Hosking), 89 B.R.
2 971 (Bankr. S.D. Fla. 1988), the debtor obtained a loan from a
3 bank so that he could invest in an oil drilling venture. The
4 debtor authorized his financial advisor and accountant to
5 prepare the documents required by the bank, which the debtor
6 understood would include a financial statement and loan
7 application. The debtor's agents prepared the necessary
8 documents, but they contained numerous materially false
9 representations. The debtor maintained that he did not read or
10 sign the documents his agents prepared but admitted to asking
11 his agents to prepare those documents; admitted to needing the
12 loan to invest in the oil drilling venture; and admitted to
13 acknowledging in writing that the bank's decision to extend
14 credit was based in part on a loan application and his
15 financial status.

16 The bankruptcy court did not believe the debtor's
17 testimony that he did not sign the loan application or
18 financial statement. But even accepting that testimony as
19 true, the court found ample evidence upon which to conclude
20 that the debtor knew or should have known of his agents' fraud.
21 The court emphasized the debtor's intelligence and experience
22 as a businessman, as well as his admissions concerning the
23 documentation required by the bank. By abandoning his
24 responsibilities as a loan applicant and paying no attention to
25 the activities of his agents, the debtor behaved recklessly,
26 which justified a judgment in favor of the bank. Hosking, 89
27 B.R. at 977.

1 In each of the foregoing cases, the debtor knew of - but
2 ignored - facts and circumstances that should have prompted him
3 to investigate the truth of representations made by his agent.
4 In Hosking, the debtor knew that obtaining a loan would require
5 a financial statement and loan application and authorized his
6 agents to prepare them, but made no effort to find out what
7 those documents actually said. In Richmond, the debtor knew of
8 his son's history of financial mismanagement but nevertheless
9 signed whatever documents the son placed before him without
10 verifying their accuracy. In Zaffron, the debtor understood
11 that the lessor would require proof of significant financial
12 backing and knew that his company did not have such backing,
13 but made no effort to investigate the representations made by
14 his partner. In each of these cases, the debtor's willful
15 refusal to pay minimal attention to the activities of their
16 agents amounted to reckless indifference. Under Walker, such
17 culpability justifies imputation of the agents' fraud to the
18 debtors and a finding of nondischargeability under section
19 523(a)(2).

20 The case before this court does not follow the foregoing
21 pattern. Mrs. Bartenwerfer did not live at the Property after
22 the relevant renovations started. Once she moved out, she did
23 not visit the Property again until she, Mr. Bartenwerfer, and
24 Mr. Monti met there to prepare the TDS. She never met with or
25 gave instructions to any of the laborers, contractors,
26 architects, or other professionals hired by Mr. Bartenwerfer.
27 She played no role in obtaining permits for the construction or
28 in working with municipal authorities with respect to those

1 permits. She and Mr. Bartenwerfer agreed that he would assume
2 full-time responsibility for the Property and its renovation
3 and they stuck to that arrangement.

4 In light of their arrangement, the court finds Mrs.
5 Bartenwerfer's conduct reasonable with respect to the
6 representations made in the TDS. She confirmed visually
7 whatever information she could. As to disclosures that were
8 not subject to visual verification, she asked Mr. Bartenwerfer
9 to confirm their veracity. It was, after all, his full-time
10 job to supervise the construction.

11 While Mr. Bartenwerfer did not possess a contractor's
12 license and had no training in construction, the court does not
13 believe these facts render Mrs. Bartenwerfer's conduct any less
14 reasonable, and certainly not reckless. Mr. Bartenwerfer
15 devoted himself full-time to the Property; Mrs. Bartenwerfer
16 logically assumed that his first-hand knowledge provided the
17 most immediate and accurate source of information concerning
18 its condition.

19 And the court received no evidence whatsoever that
20 suggested Mrs. Bartenwerfer might have received any hint of
21 defects in the Property through other channels. Put another
22 way, Mr. Buckley did not prove that Mrs. Bartenwerfer knew of
23 but ignored facts that should have prompted her to investigate
24 the representations set forth in the TDS beyond asking Mr.
25 Bartenwerfer to confirm the accuracy of information she could
26 not verify herself by visual inspection.

27 And finally, the court does not believe that the fact Mrs.
28 Bartenwerfer could have asked, but did not, to review permits,

1 construction drawings, invoices, checks, or other documents
2 requires a difference result. Nothing in Huh, Walker, or any
3 of the other relevant caselaw requires a debtor to
4 independently verify each and every representation made by his
5 or her agent. If debtors were held to such a standard, it
6 would render debtors liable for all misrepresentations made by
7 their agents - a standard the BAP has rejected. Huh, 506 B.R.
8 at 266. The Walker standard implicitly acknowledges that a
9 principal must be able to trust and rely on his or her agent
10 unless the principal knows or has reason to know of cause not
11 to, and rightfully so. Otherwise, there would be little point
12 to principal-agent relationships. It is only where a debtor
13 learns of facts that require investigation into the agent's
14 conduct but fails to undertake such an inquiry that a court can
15 find that the debtor "should have known" of the agent's fraud
16 and can impute such fraud to the debtor. Mr. Buckley failed to
17 prove that Mrs. Bartenwerfer knew of any such facts.

18 **E. Conclusion**

19 For the foregoing reasons, the court will render judgment
20 on Mr. Buckley's complaint in favor of Mrs. Bartenwerfer.
21
22

23 ****END OF ORDER****
24
25
26
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Court Service List

[None]